An inquiry into the Impact of Financial Inclusion on Rural Households - Evidence from a Field level Study

SYNOPSIS

Backdrop of the study:

Financial inclusion has been the most talked-about topic. It can be characterised as a method of making reasonable, timely and adequate financial services available to the most vulnerable members of society since last decade. Financial inclusion has received renewed and greater attention worldwide in the post-2010 period. In India too, the financial inclusion landscape has also changed significantly over the last few years with several initiatives by the government of India and the Reserve Bank of India. The Committee on Financial Inclusion headed by Dr. C Rangarajan, former governor of RBI, was the first to formalize the concept of financial inclusion in India, in 2008. This Committee defined financial inclusion as "the process of ensuring access to financial services, timely and adequate credit for vulnerable groups such as weaker sections and low-income groups at an affordable cost." In keeping with the growing attention from practitioners, researchers, and academicians, several studies have been undertaken to understand the different sides of financial inclusion.

Financial inclusion process is helpful for widening the product and service and spreading the services in different parts of the society. It is treated as a top priority worldwide from underdeveloped to developed nations. This can be appreciated from the fact that almost 60 countries have either launched their national strategy for financial inclusion or are working to develop a sustainable inclusive strategy. Though developed world already has achieved much progress, financial inclusion remains a challenge for the developing and

underdeveloped countries. Most of the India specific studies have approached financial inclusion at the country level. There are limited number of studies that attempted to understand the nuances of financial inclusion at the regional level. Further most of the India specific studies on financial inclusion have focused on the issue of access to financial services. Studies on efficacy of financial inclusion in improving the socio financial-economic status of rural households are limited. Hence, this study is an attempt to understand the impact of financial inclusion on rural poor households addressing specific dimensions of household wellbeing, responsible usage of financial services, and non-institutional sources of supply. Our research objectives are based on the gaps found from an extensive literature review and considering experts' opinions.

The present study speaks about the need to understand various channels through which financial deepening can happen for rural poor. It is also important to identify numerous factors influencing financial inclusion. It is surprising to observe that when financial services are provided from the supply side, users lack interest to use them and when there are demand sides requirements, service providers are unable to cater to the customers' need. Despite policy on implementation to use different services delivery channels, it's fascinating to learn that the poor's financial demands aren't being satisfied. Literature highlights that significant improvement has taken place and include the excluded through financial inclusion process, yet limited use of services by the economy class and downtrodden people. However, the literature does not reveal much about how the consumers in rural areas intend to use different financial products (like savings, credit, investments, etc.). In this setting, other problems arise, such as whether financial inclusion leads to responsible use of financial services, and how extending financial inclusion affects impoverished people's financial habits, especially their credit culture. Getting answers to these questions will not only help the users but it contributes for building stable and sustainable inclusive financial system in the country. This dissertation is an attempt to find answers to some of these questions through a field study in the State of Odisha.

This research aims to uncover numerous elements (constituent variables) that contribute to financial inclusion. It also investigates the effects of financial

inclusion on a variety of variables. Relying based on the conclusions of various authors who have tried to understand the reasons behind non-use of bank accounts in developing countries including India, the reasons of non-use of bank accounts include, expensiveness of bank account, lack of desired service quality, inconvenient operating hours, locations of bank branches, lack of trustworthiness of banks and high transaction costs. Lack of surplus money and behavioural constraints of the users also have an impact. It is also observed that several factors contribute to greater use of financial services. For instance, customers are more inclined to use financial services provided by the formal institutions because their staff are more effective in resolving various challenges faced by the customers. Remittance facilities can include the financially untouched population into the fold of financial inclusion. As far as impact of financial inclusion is concerned, studies find that financial inclusion will be more effective if poor households get access to financial services beyond credit like Insurance, Savings, and payment systems. It is observed from the previous research that access to affordable financial services such as credit and insurance enlarges the livelihood opportunities and empower the poor to change their lives. Financial inclusion provides a platform for safe savings, insurance, entrepreneurial loans, payments and settlement facilities, and other allied services, increasing business opportunities for the rural households . Availability of financial services creates an environment for people to get access to deposits, credit, insurance, remittance, pensions, etc. From a different perspective, the financially excluded households become socially excluded with bad health and education, unemployment, family breakdown, etc.

Fostering financial inclusion encourages savings habit among the poor and helps in asset creation by accumulation of funds. It helps in meeting various needs of rural households like enterprise finance, better education, and health for children. It improves the people's choice for a healthy and long life and to be financially educated and better standard of life. It leads to the path towards financial stability in the form of widening and deepening financial products and encouraging for saving and working for the creation of capital and provides fuel for the economic growth, which is considered as a prerequisite for empowerment and social cohesion. But the most essential part from service

provider's side as supplier of financial services is to understand well about what the customer wants to buy and in what quantity.

We find from the literature that there are both antecedents and impacts associated with the financial inclusion. Many studies gave attention towards different dimensions (factors) related to financial inclusion and its impact. After our rigorous review of extant literature, opinion of experts and discussion with Thesis advisory committee it is stated that the following mentioned factors significantly affecting the status of financial inclusion at any region. Apart from the findings from literature a few new factors that looked to be significantly important for affecting financial inclusion status were added to it. Considering this fact, this study included availability of credit, attitude of service provider, adequate provision of credit, ease of credit, attitude of users and usage of loan as constituent variables and better financial services availability, responsible use of financial services, well-being of households, removal of non-institutional source of finance and fulfilment of financial need of households as outcomes.

Challenges in Financial Inclusion

Financial inclusion involves extending access to financial services at an affordable cost. However, it has been often viewed narrowly as meeting the credit needs of the poor by the mainstream players. Even with this narrow credit centric view of financial inclusion, the high level of dependence on non-institutional sources for meeting the credit requirement is a policy concern. Notwithstanding the progress made, gender gap in account ownership continues to be a concern at the global level. The key challenges in meaningful financial inclusion across worldwide is the inactive accounts and gender discrimination in account ownership. Though India has made considerable progress in broadening account ownership and reducing gender disparity, addressing the issue of inactive accounts is the major challenge. From a different perspective, while financial inclusion is beneficial, it can be counterproductive if lending is done beyond the absorptive capacity of the borrower. Another issue which has received very little attention but critically important is about usage of funds. Easy availability of credit from multiple

institutions might encourage irresponsible usage of funds and thus, affecting the credit behaviour of the users. All the above issues have significant policy implications and need careful study.

Having discussed the overall backdrop, policy initiatives, progress made, and challenges in financial inclusion, an attempt has been made to understand the status of financial inclusion in Odisha. The state has abundant natural resources and a large coastline. The extensive forest resources provide ample scope for forest-based activities. Agriculture continues to be the backbone of the state's economy as majority of the population depends on agriculture for their livelihoods. However, despite such natural resources, Odisha is still considered as one of the poorest states in the country. In view of that state government has been taking multiple measures to alleviate poverty and promote development in Odisha .

Odisha's government, like those of most other Indian states, has taken a number of steps to promote financial inclusion. These initiatives include the establishment of Mission Shakti, the promotion of SHGs and their federations, financial and capacity-building assistance to them, and the implementation of large-scale projects with financial inclusion components, among others. One of the most important avenues for delivering financial services to impoverished women in the state has been the SHG-Bank Linkage Program (SBLP). According to reports, Mission Shakti has a total of over 70 lakh women involved in over 6 lakh SHGs across the state. The Odisha Livelihoods Mission (OLM) has also been promoting and building SHG federations at the community level. The Reserve Bank of India, NABARD (National Bank for Agriculture and Rural Development), SLBC (State Level Bankers Committee), banks, NGOs (Non-Governmental Organizations), MFIs (Micro Finance Institutions), and SHPIs are among the other important stakeholders (Self-Help Promoting Institutions) .

The government of Odisha during this pandemic has taken certain steps related to ECLGS (Emergency credit line guarantee scheme), PMEGP (prime minister employment generation program) and PMFMP (primary MSME formation and

development program). Notwithstanding the progress made in Odisha, there are several challenges to achieve further progress in financial inclusion. The state has huge pockets of unbanked villages and inadequate infrastructure has been a major hurdle for opening banking outlets in these areas. Various government programmes, including as the PMJDY (Pradhan Mantri Jan Dhan Yojana) accounts, have not been very motivating for the rural poor to use their bank accounts. It is seen as a critical catalyst for expanding financial inclusion for the poor, and its importance is felt strongly in Odisha, given the state's low literacy rate and weak banking infrastructure, especially in rural regions. Due to a lack of banking infrastructure and delivery channels, the state's unbanked poor are forced to rely on high-cost informal service providers. Offering customized product based on the need of the customer and to understand the limitation of existing models for the financial inclusion are limited. The present policy of opening of branch and ATM in the state signifies that, banks are yet to provide importance for installation of ATM at rural branches

Research Gaps

We noticed varied views in the literature on the approach to measure financial inclusion. Existing indices of financial inclusion suffer from conceptual and methodological shortcomings as they fail to accurately measure various dimensions of financial inclusion which are incorporated into its definition. Different dimensions of financial inclusion were treated as fully substitutable. Financial inclusion indices are often based on aggregate indicators that do not tell much about an individual's access to or use of financial services. The literature also indicated that some of the progress in improving financial inclusion could reflect a bias towards measures based on access. This study recommends composite measures of financial inclusion using CFA or alternative methods to ensure index constructions follow a systematic approach in terms of defining dimensions, selecting variables, and deriving weights .

India has experienced significant improvement in terms of reach to the bottom of the society for providing financial services. However, use of services

is rather limited in the rural people. The literature is silent about how the consumers in rural areas intend to use financial products. The literature also limits itself on the habits and behavior of the consumers affects the usage of financial services. By ensuring these two things, it will not only help the users improve their socio-economic status but also help building a stable and sustainable inclusive financial system in the country. This creates the need for the proposed study, and also to understand the impact on responsible usage of various financial services, reducing non-institutional sources of credit and building good financial habits of users.

Research objectives

Five broad research objectives were formulated in this study which are; i) To assess whether financial inclusion facilitates better access of financial services for rural households, ii) To assess whether financial inclusion helps in responsible usage of financial services, iii) To explore if financial inclusion improves the wellbeing of rural households or not, iv) To know if financial inclusion increases dependency on non-institutional sources of credit, and v) To examine if financial inclusion contributes to fulfilling the overall financial needs of rural households. To accomplish these objectives, the study attempts to explore the constituent variables that explain financial inclusion in a holistic manner. After explaining financial inclusion in holistic manner, it also understands the relationship between the latent construct, its impact on five different outcome variables defined in the study, which are explained as well-being of households, fulfilment of financial needs, removal of non-institutional source of finance, responsible usage and reach of financial services. These outcome variables and their relationship with financial inclusion (latent construct) would be tested to confirm hypotheses constructed accordingly.

The extant literature has conceptualised financial inclusion in a much traditional way, considering one or two aspects of financial inclusion. To mention a few of these studies on financial inclusion we have referred some of these most sought works done. Various authors have tried to understand the reasons behind non-use of bank accounts in developing countries including India are bank accounts tend to be expensive, lack desired service quality,

inconvenient operating hours, large distance to branches, lack of trustworthiness of banks, high transaction costs, lack of surplus money and behavioural constraints, thus affecting status of financial inclusion. Financial Inclusion is broadly affected by high cost of services, physical distance of the service provider and lack of proper documents. Availability of credit including disbursement place, processing time, loan sanction time, loan disbursal time. The study tried to define financial inclusion and to identify the factors that influence it. It also develops a conceptual model which included all the constituents of financial inclusion to define it in a holistic view. The items defined by all these constituents were included to define "financial inclusion" as one single latent construct. Thus, the items used for the constituents of financial inclusion were also taken as the key determinants for the purpose of analysis and its impact on five different outcome variables defined in the study, which are explained as Well-being of households, fulfilment of financial needs, removal of non-institutional source of finance, responsible use of financial services and access to financial services.

Research area

The Research has been carried on in Nayagarh District of Odisha as the population for the study. From a socio-economic point of view, Nayagarh is one of economically poor district. The present study has taken only this District as many Micro-finance institutions have penetrated and provided financial assistance in terms of micro loans to many rural households. The study will influence to understand the demographic details of the respondents and to provide financial assistance to this area people.

Research Methodology

The study used both primary and secondary data on financial inclusion. Secondary data were collected from various stakeholders (SLBC, RBI, MFIN, The World Bank, etc.). Household surveys with standardised questionnaires were used to acquire primary data. Households were chosen utilising a stratified sample approach and a well-designed schedule. Area of survey was finalised using cluster analysis in SPSS. A summated scale was created for the individual factors to be included in the Cluster Analysis. A sample size of 400

from four blocks was finalised for conducting the household survey. The view of the experts in the same domain and previous literature were also considered to develop the questionnaire. The demographic variables were measured using interval, nominal, and ordinal scales. The list of factors affecting financial inclusion, which was obtained from a review of existing literature and interview method, was scrutinised by a panel comprising academicians and industry experts to ensure content validity. The construct was validated and proved that the model constructs satisfy reliability and validity criteria. The study has considered both multivariate techniques to explore the factors of financial inclusion. It also used the structured equation modelling (SEM) in this research to statistically test the hypothesized model.

In the present study different statistical tools like univariate, bivariate (cross tables) and multivariate techniques have been used to achieve the objectives. Univariate tools are used to introduce the respondents and then bivariate like cross tables etc. are used to see the relationship (in tabular form). The multivariate tools have been used and then Structural Equation Modelling (SEM) used to validate the proposed model and to understand the hypothesised relationship defined in the proposed model and the Partial Least Square (PLS), is also used to understand the path model.

The study used convergent and discriminant analysis for data analysis and testing of hypotheses. It tests the causal relationship between the theoretical hypotheses of the study. SEM is used to ascertain whether the proposed model is fit for reproducing the data using defined variables or not and minimise the measurement errors by defining multiple indicators per each of our constructs in the study. A theory has been developed to define the construct or research framework. Stata version 11.0 is used for demographic data analysis and cross tabulation. For activities ranging from the pilot study through the main study, such as coding, editing, validating missing data, assumptions of normality, outliers, and factor analysis, the SPSS 21.0 version was used. The factors of financial inclusion were investigated using exploratory factor analysis (EFA) . Confirmatory Factor Analysis was used to confirm the factors (CFA). The link

between the dependent and independent variables was studied using structural equation modelling (SEM).

Broad research findings

The study has five objectives. First, to assess whether financial inclusion facilitates better access of financial services for rural households. Second, to understand how financial inclusion helps in responsible usage of services. Third, to explore if financial inclusion improves the wellbeing of rural households or not. Next, to know if financial inclusion increases dependency on non-institutional sources of credit. Lastly, to examine if financial inclusion contributes to fulfilling the overall financial needs of rural households. Five hypotheses have been formulated based on the objectives and tested in null form using the finding from the implementation of SEM.

1. According to the first null hypothesis, financial inclusion does not facilitate better access of financial services for rural households. The structural equation modelling results revealed that the hypothesised path was positive and statistically significant (t=18.591, β =0.710, P 0.05), rejecting the null hypothesis. As a result, it has been proven that financial inclusion facilitates access to financial services for rural households.
2. "Financial inclusion does not influence responsible use of financial services," the second hypothesis said. The structural equation modelling results revealed that the hypothesised path was positive and statistically significant (t=20.827, β =0.736, P 0.05), rejecting the null hypothesis. As a result, it has been proven that financial inclusion enhances responsible use of financial service use.
3. Similarly, third hypothesis was that Wellbeing of rural households is not improved by financial inclusion. Our findings on the structural equation modelling tested the hypothesized path positive and significant (t=19.549, β=0.719, P< 0.05), thus rejecting the null hypothesis. This validates our hypothesis that financial inclusion and household well-being are linked in a favorable and significant way.
4. Fourth hypothesis of the study was “Financial inclusion increases dependency on non-institutional sources of credit.” The findings from the

structural equation modelling suggest the hypothesized path to be positive and significant (t=21.656, β=0.706, P< 0.05), thus rejecting the null hypothesis . This confirms that increase in status financial inclusion decreases dependency on non-institutional sources of credit.

5. Lastly, the fifth hypothesis that financial inclusion does not contribute to fulfil the overall financial needs of rural households. The results of the structural equation modeling suggested that the relationship was positive and significant (t=36.698, β=0.724, P< 0.05), thus rejecting the null hypothesis. Therefore, our postulation confirms that financial inclusion contributes fulfillment of overall financial needs of rural households.

Research contribution

It paved the ways for the research community to understand the nitty-gritty of the financial inclusion models undertaken. This study was conducted in the rural periphery of Odisha and in particular Nayagarh district where the penetration of financial inclusion has happened mostly because of the microfinance institutions. This has motived us to understand the implication of financial inclusion and provide a formidable suggestion to improve the well-being of the households . Through the study it is reviewed that some of the concerns of financial inclusion with a clear structural analysis to provide authentic results. Financial researchers, sociologists, and management analysts apply different methods and theories. The study considered the commonly applied theories to examine the research essence, chose the relevant, and synthesized the integrated theories to make it predictable for the policy decision.

Financial inclusion process developed explains its relevance for development of society as well as enhancing economy of the country. The current study explains how they matter in a specific context – that is, for well-being of the individuals in the emerging economy setting. The current study provides empirical evidence supportive of the study's overarching thesis that financial inclusion has a strong influence on removing the middleman from credit facility available in the market and to bring transparency in the system facilitating a platform for enhancement of

socio-economic wellbeing of rural households and removal of informal sources of credit to a great extent .

Here the study demonstrates that financial inclusion is theoretically risk-taking initiative, pro-activeness, and new one and is related to growth and social freedom of the people residing in the bottom of the pyramid. Moreover, the results provide a micro-perspective on the view that financial inclusion shape economic development such that specific categories of the institutions were found to influence economic growth of the country. The focus on financial inclusion is a contribution to the current debate on how it shapes economic growth of the country, which is at the core of the study of new economics. The current study went beyond the simple thesis that financial inclusion matter and sought to understand how it matters to what extent and in what ways .

The study identified six factors affecting the financial inclusion, which have been categorised as constituents of financial inclusion, thus combinedly defining it. The study further signified that financial inclusion enhanced the well-being of the individuals and it has helped people to create surplus assets for their family. It also confirmed that adequate provision of credit facilitates financial inclusion and usage of loan, availability of credit, ease access of credit, attitude of users and attitude of service provider holds positive. On the other hand, financial inclusion also leads to responsible usage of financial services.

Scope for further Research

The research work has laid much emphasis on the understanding of different aspects of financial inclusion and analysing the problems, prospects, and strategies for effective implementation of financial inclusion plans and policy decision. Understanding the stake holders' perspective may help in removing the discrepancies and make it more effective. The issue of financial inclusion can be a pivotal issue for understanding the rural consumers and retaining consumers' future issues. Research on financial inclusion in terms of factors, effectiveness,

awareness, and their behaviour in India could help financial institutions to rework on their strategies. Other interesting aspects would be to see if this model changes with geography (cultural influences), financial awareness and demographics of respondents. Well-being is just one component of financial inclusion and how does it vary across the demographic section is the issue which can be studied further. It is important to find out how it relates to other factors like credibility and association which are the issues to be studied further.

The National plan for financial inclusion (2019-24) was launched in India in January 2020 and will be implemented across the country in a time-bound way. To make it more effective and relevant, more research is needed to learn how to improve service availability and make financial products more accessible to excluded groups and the larger society in general, in order to promote their growth and development.

Limitations of the study

Due to a variety of factors, the study had some limitations. The sample size for household survey is limited due to cost and time considerations, though the required size as per statistical guidelines is maintained. Digital finance segment is excluded from this study, considering very minimal penetration so far in India during the period of study. Further, Insurance, Mutual Funds and Remittance services have been kept out of the scope of this study because of their low penetration. While analysing the source of credit all non-institutional sources like chit funds, money lenders, SHGs, etc. are not covered under this study being exploitative and non-regulatory in nature.